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# Design and roles of the sectoral regulator and the competition authority in liberalized energy markets

30 May 2018



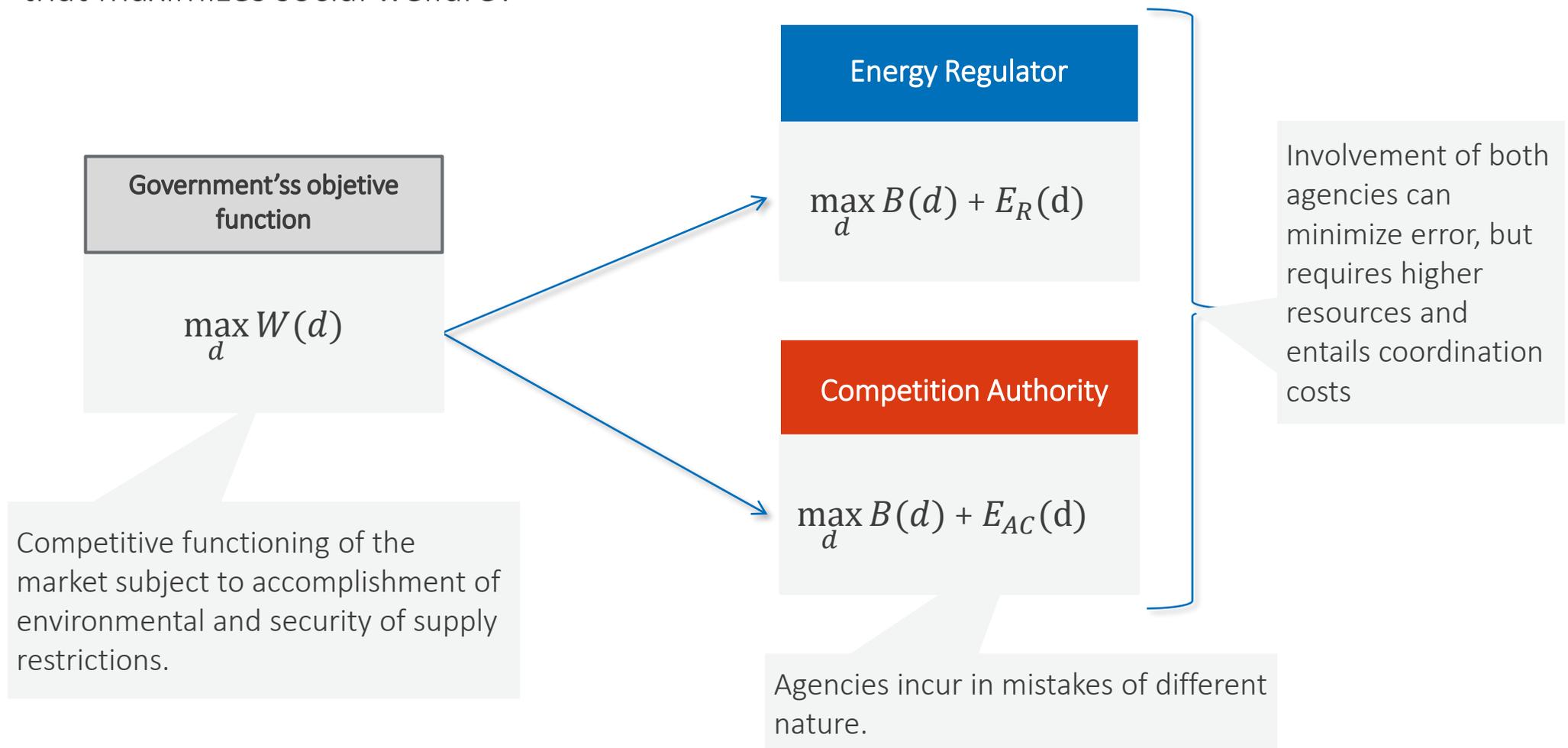
# LIBERALIZED ENERGY MARKETS ARE HEAVILY REGULATED AND SUPERVISED

Main tasks	Description
Market and regulatory design	<ul style="list-style-type: none"><li>■ Assisting the Government in developing new regulations or modifying existing regulations.</li></ul>
Implementation of REMIT and other sectoral regulations	<ul style="list-style-type: none"><li>■ Investigation and resolution of REMIT cases.</li></ul>
Implementation and enforcement of competition law	<ul style="list-style-type: none"><li>■ Coordinated conduct (Article 101 of TFUE)</li><li>■ Abuse of dominant position (Article 102 of TFEU)</li><li>■ Merger control</li></ul>
On-going market supervision to ensure:	<ul style="list-style-type: none"><li>■ Compliance of market agents with sectoral regulation.</li><li>■ Compliance with REMIT.</li><li>■ Correct functioning of energy markets.</li></ul>

It is not always clear which agency should be responsible for each of these tasks. International experience shows a variety of possibilities.

# FRAMEWORK: PRINCIPAL AGENT MODEL

- The problem we are trying to solve is: How do we allocated each of the different tasks among the i) the Energy Regulator, ii) the Competition Authority or iii) both agencies in way that maximizes social welfare?



# AGENCIES HAVE DIFFERENT CHARACTERISTICS

	Energy regulator	Competition Authority
<b>Mandates</b>	<ul style="list-style-type: none"> <li>Subject to multiple objectives: competitive market functioning as well as environmental and security of supply objectives.</li> </ul>	<ul style="list-style-type: none"> <li>Focused on enforcing competitive market functioning</li> </ul>
<b>Degree of specialization</b>	<ul style="list-style-type: none"> <li>In depth knowledge of market design and regulations in wholesale electricity and gas markets.</li> </ul>	<ul style="list-style-type: none"> <li>In depth knowledge of competition economics and competition law.</li> </ul>
<b>Potential of regulatory capture</b>	<ul style="list-style-type: none"> <li>Frequent contact with the energy industry both in public and private forums.</li> </ul>	<ul style="list-style-type: none"> <li>Does not have frequent contact with any sector.</li> </ul>
<b>Regulatory synergies</b>	<ul style="list-style-type: none"> <li>Responsible for access regulation in natural monopoly segments (transmission and distribution networks).</li> </ul>	<ul style="list-style-type: none"> <li>None.</li> </ul>
<b>Interactions with other sectoral regulators</b>	<ul style="list-style-type: none"> <li>Interacts with other sectoral regulators (e.g. ACER, CEER).</li> </ul>	<ul style="list-style-type: none"> <li>Interacts with other competition authorities in EU.</li> </ul>

# DUE TO THEIR DIFFERENT CHARACTERISTICS AGENCIES ARE PRONE TO INCURRING IN DIFFERENT TYPES OF ERRORS

Source of error	Energy regulator	Competition Authority	
Consideration of multiple objectives	✓	✗	When these factors are more important: Allocate task to Energy Regulator
Sectoral knowledge	✓	✗	
Regulatory capture	✗	✓	When these factors are more important: Allocate task to Competition Authority
Experience in application of competition law	✗	✓	
Homogenous application of competition law across sectors	✗	✓	

# ALLOCATION OF TASKS DEPENDING ON RELATIVE IMPORTANCE OF ERROR TYPES

Source of error/Task	Regulatory/ market design	REMIT	Merger Control	102 Cases	101 Cases
Consideration of multiple objectives	✓		✓		
Sectoral knowledge	✓	✓	✓	✓	✓
Regulatory capture	✓	✓	✓	✓	✓
Experience in application of competition law			✓	✓	✓
Homogenous application of competition law			✓	✓	✓

<p>Tasks should allocated to <b>Energy Regulator</b> (with possibility of intervention from Competition Authority to minimise risk of regulatory ).</p>	<p>Tasks allocated to <b>Competition Authority</b> (possibility for contribution from Energy Regulator).</p>	<p>Tasks allocated to <b>Competition Authority</b> only.</p>
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# ALLOCATION OF TASKS IN PRACTICE

Source of error/Task	Regulatory/ market design	REMIT	Merger Control	102 Cases	101 Cases
<b>Germany</b>	Regulator with input from CA	Energy Regulator	CA with input from Energy Regulator	CA with input from regulator	CA
<b>France</b>	Energy Regulator	Energy Regulator	CA	CA with input from regulator	CA with input from regulator
<b>Netherlands</b>	Energy department	Energy department	Competition department	Energy department	Competition department
<b>Italy</b>	Energy Regulator	Energy Regulator	CA	CA	CA
<b>United Kingdom</b>	Energy Regulator	Energy Regulator	CA with input from Energy Regulator	Concurrencies	Concurrencies
<b>United States</b>	Energy Regulator	Energy Regulator	Both can block merger.	CA	CA

Tasks should allocated to **Energy Regulator** (with possibility of intervention from Competition Authority to minimise risk of regulatory ).

Tasks allocated to **Competition Authority** (possibility for contribution from Energy Regulator).

Tasks allocated to **Competition Authority** only.



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# Excessive prices in wholesale electricity markets

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# TWO DIFFERENT APPROACHES USED TO ADDRESS EXCESSIVE PRICES IN WHOLESALE ELECTRICITY MARKETS

## Competition framework

- The existence of excessive pricing under competition law would require:
  - Defining the relevant market in which the infraction took place.
  - Proving the existence of dominance in the relevant market defined.
  - Proving the existence of excessive pricing: Price unrelated to the “economic value” of the product supplied. From an economic perspective this is equivalent to i) prices resulting from a perfectly competitive market or ii) prices resulting from long-run competitive equilibrium.

Higher likelihood of Type II errors (i.e. not imposing a penalty when it should be imposed)

## “Market manipulation” approach

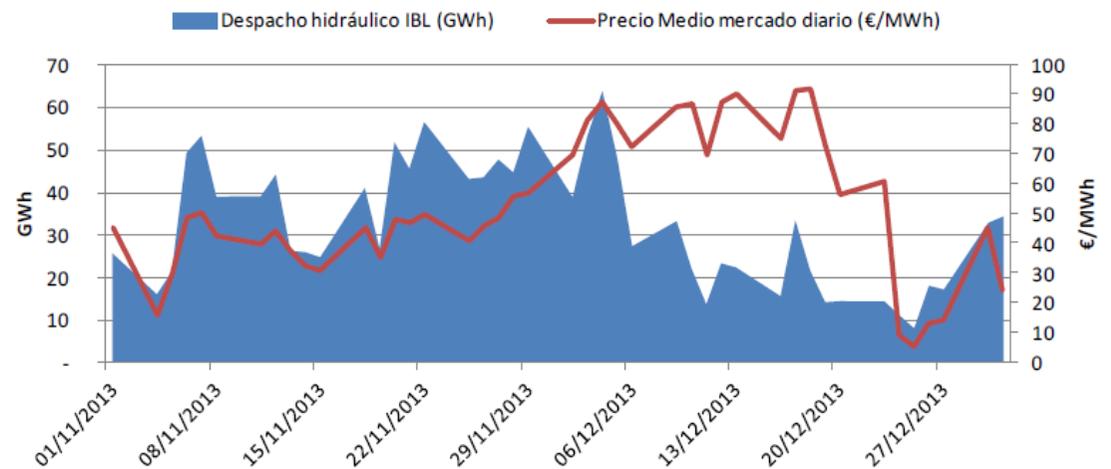
- The existence of excessive pricing under REMIT article 5, or under some national electricity laws departs from the competition framework:
  - Example 1 – REMIT article 5: “Not offering on the market, without justification, a power plant whose marginal cost is lower than the spot prices, resulting in abnormal high prices”.
  - Example 2 - Spanish Electricity law: Constitutes and infringement of electricity law “Offers in wholesale electricity markets that are disproportionate or abnormal”

Higher likelihood of Type I errors (i.e. imposing a penalty when it should not be imposed)

# EXAMPLE: SPANISH GENERATOR (2013): MANIPULATION OF SPANISH DAY-AHEAD MARKET

## Infringement

- Market manipulation through the submission of high price offers to the day-ahead market by several hydro plants during November 2013 –December 2013.
- The objective of the manipulation would have been to withhold hydro capacity and increase market prices.



## What the CNMC analysed

- Analysed bidding behaviour of generator's hydro plants during the period investigated.
- Concluded that Iberdrola submitted bids at around 87€/MWh that were above its opportunity costs, estimated to be around 80 €/MWh.
- Resulted in a fine of 25 M€.

## What the CNMC did not analyse

- Did not pronounce itself on what was the relevant market.
- Did not pronounce itself on whether the generator had a dominant position.
- It did not consider other estimates of the "economic value" of electricity other than the opportunity cost.

# PRACTICAL IMPLICATIONS OF DEPARTING FROM A COMPETITION FRAMEWORK

## Competition framework

### Advantage

- Ensures homogenous criteria with other sectors, thus not distorting investment decisions across sectors.
- Higher standard of prove will result in less type I errors, thus encouraging investment.

### Disadvantage

- Can lead to some abuses not being detected, due to higher standards of proof required, resulting in consumer loss.

## “Market manipulation” framework

- Allows greater flexibility in determining those practices that constitute an abuse, minimizing short run consumer harm resulting from abuses.

- Can lead to over-intervention, hence discouraging innovation and investment.

### Open question

Given that i) unprecedented large amounts of investment are needed for a low carbon transition of the energy sector and ii) the fact that the generation sector is perceived by investors to embed higher risk (compared to 10 years ago), should regulation favour Type I errors over Type II errors?



THANK YOU!